M/s PRANJAL JOSHI & CO
CHARTERED ACCOUNTANTS
Office No. 9, Suvan Apartments, Opp. Jog High School, HDFC Bank Building, Mayur Colony, Kothrud, Pune – 411 030. Tel – 020 – 25 43 02 76, Mob: 98500 35736, e-mail: capranjaljoshi@yahoo.com

Basic aspects of Business Valuation

Meaning and Purpose of Business Valuation – Business Valuation is the act or process of determining the value of a business enterprise or ownership interest therein. Valuations of businesses, business ownership interests, securities, tangible or intangible assets may be performed for a wide variety of purposes, which can be classified in following 3 circumstances –

- Valuation for financial transactions – Purchase or sell of business, business undertakings, Branch Valuation & Licensing, Franchisee Agreements, Employee stock ownership plans and share based plans, Partner and shareholder buy-ins or buyouts etc.

- Valuation for Dispute Resolution – Business disputes, Marital dissolution, Bankruptcy, contractual disputes, owner disputes, dissenting shareholder and minority ownership oppression cases, employment disputes and intellectual property disputes etc.

- Valuation for Accounting and Legal Purposes – Financial reporting and Tax matters such as corporate reorganizations; income tax, Property tax, and Wealth tax compliance; purchase price allocations; and charitable contributions.

- Other purposes like valuation for planning, Internal use by the owners etc

Approaches to Valuation – Most common approaches used in valuation are Asset Based approach, Market based approach and Income based approach. Generally more than one approach should be used.

- Asset based approach – under this approach, adjusted net asset method is popularly used where starting point is the net worth based on the latest balance sheet wherein adjustments are made to assets and liabilities to reflect realizable value, net of tax obligations. While doing so, even the liabilities not provided for or assets not accounted for may also be taken into consideration. While valuing intangible assets under this approach, reproduction cost or replacement cost may be used. The asset-based approach should not be the sole valuation approach used in assignments relating to operating companies valued as going concerns.

- Market Based Approach – This approach is a general way of determining a value indication of a subject matter based on the prices at which similar assets / subject matters are sold. Three frequently used valuation methods under the market approach are Guideline public company method, Guideline company transactions method and Guideline sales of interests in the subject entity, such as business ownership interests or securities. While for valuation of intangible assets methods used are Comparable uncontrolled transactions method, Comparable profit margin method or Relief from royalty method.

- Income Approach – under this approach value is determined based on anticipated future benefits. Two frequently used valuation methods under the income approach include the capitalization of benefits method (for example, earnings or cash flows) and the discounted future benefits method (for example, earnings or cash flows).

Premise of Valuation – This is the most important aspect of valuation. Premise refers to the scenarios under which valuation is being done i.e. whether as going concern basis or liquidation basis. Change in premise will drastically change the valuation.

Standard of Value – Standard of value means the indication of the type of value being used in a specific engagement. Different standards of value may lead you to different conclusions of Value. Therefore, it is most important for the Valuer to identify a standard or definition of value pertinent to the case. There are broadly four standards of value: Fair market value, Fair value, Investment value, Intrinsic value or fundamental value

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Valuation adjustments - The purpose, applicable standard of value, or other circumstances of an engagement may indicate the need to account for differences between the base value and the value of the subject interest. Examples of valuation adjustments include a discount for lack of marketability or liquidity and a discount for lack of control.

Contents of Valuation Report – Detailed Valuation Report shall contain the following –

- Letter of Transmittal
- Table of contents
- Introduction
- Sources of information
- Analysis of the subject entity and related nonfinancial information
- Financial statement/information analysis
- Valuation approaches and methods considered
- Valuation approaches and methods used
- Valuation adjustments
- Non operating assets, non operating liabilities, and excess or deficient operating assets (if any)
- Representation of the Valuer
- Reconciliation of estimates and conclusion of value
- Qualifications of the Valuer
- Appendices and exhibits

Conclusion of Value – Conclusion of value may be a single figure or range of figures depending upon the Purpose and Standard of Valuation.